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**THE COTTON/
TEXTILE
SUBSECTOR IN
EGYPT:
IMPACTS OF
POLICY
REFORM**

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LIST OF ACRONYMS

ACC	Agricultural Commodity Council
APCP	Agricultural Production and Credit Project
APRP	Agricultural Policy Reform Program
ARC	Agricultural Research Center
CAAE	Central Administration for Agricultural Economics of MALR/EAS
CAPMAS	Central Agency for Public Mobilization and Statistics
CATGO	Cotton Arbitration, Testing and Grading Organization
C&F	Cost and freight
CIF	Cost, insurance and freight
CRI	Cotton Research Institute (of ARC)
EAS	Economic Affairs Sector (of MALR)
EE	Eastern Europe
EEPC	Egyptian Export Promotion Center (of MFT)
EPIQ	Environmental Policy and Institutional Strengthening Indefinite Quantity Contract
ERS	Economic Research Service (of USDA)
ESA	Employee stakeholder association(s), a form of privatization
EU	European Union
FAO	Food and Agriculture Organization (of the United Nations)
FAS	Foreign Agricultural Service (of USDA)
fd.	Feddan (equivalent to 0.420 hectares or 1.037 acres)
FOB	Free on board
FSRU	Food Security Research Unit of APRP
GASC	General Administration for Supply Commodities (within MSIT)
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GOEIC	General Organization for Export and Import Control
GOE	Government of Egypt
HC	Holding Company
HC-SWRMC	Holding Company for Spinning, Weaving and Ready-Made Clothes
HE	His Excellency
HSU	Horticultural Services Unit
ICAC	International Cotton Advisory Committee
IFPRI	International Food Policy Research Institute
ISP	internet service provider
kg.	kilogram
LE	Egyptian Pound
lk	lint kantar (or a metric kantar) = 50 kg
MALR	Ministry of Agriculture and Land Reclamation
MFT	Ministry of Foreign Trade (formerly MEFT)
mlk	million lint kentars (where one mlk = 50,000 mt)
MPE	Ministry of Public Enterprise
MPWWR	Ministry of Public Works and Water Resources (former name)
MSHT	Ministry of Supply and Home Trade
mt	metric ton

mmt	million metric tons
MVE	Monitoring, Verification, and Evaluation Unit of APRP
MWRI	Ministry of Water Resources and Irrigation
NIS	Newly Independent States (of the former Soviet Union)
PBDAC	Principal Bank for Development and Agricultural Credit
S&O	Situation and Outlook (reports and reporting)
TCF	Textile Consolidation Fund
UR-GATT	Uruguay Round, General Agreement for Tariffs and Trade
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
WTO	World Trade Organization

PREFACE

This report is the final MVE assessment of the impact of policy reform on the cotton subsector in Egypt. It is an expanded version of a presentation given on 3 June 2002 at the APRP/MVE Unit Impact Assessment Conference, held in Cairo from 1-4 June 2002. It is not an exhaustive treatment of developments in the cotton subsector over the life of the policy reform program. The reader is referred to earlier MVE impact assessment reports, some of which are listed below, and several APRP/RDI Unit and CSPP technical reports for details.

Krenz, Ronald, John Holtzman, Adel Mostafa and Mohammed Abu El Wafa. **Policy Lessons from the 2000/2001 Cotton Marketing Season in Egypt.** MVE Unit - APRP, Impact Assessment Report No. 17 and CSPP Report No. 96. Abt Associates Inc. and Cotton Sector Promotion Programme (GTZ/MALR), Cairo, Egypt. July, 2001.

Holtzman, John. **Liberalization and Privatization of Key Subsectors in Egypt's Agricultural Economy: Progress and Challenges.** MVE Unit - APRP, Impact Assessment Report No. 14. Abt Associates Inc. Cairo, Egypt. November, 2000.

Krenz, Ronald and Adel Mostafa. **Seed Cotton Marketing in Egypt, 1999/2000.** MVE Unit - APRP, Impact Assessment Report No. 11. Abt Associates Inc. Cairo, Egypt. March, 2000.

Holtzman, John, in collaboration with Adel Mostafa. **Cotton Subsector Baseline Study.** MVE Unit - APRP, Impact Assessment Report No. 5. Abt Associates Inc. Cairo, Egypt. December 1998.

This final cotton subsector impact assessment report is meant to be a synthesis of findings over five and a half years of policy reform and changes in subsector structure, conduct and performance of the cotton/textile subsector in Egypt. It highlights the impacts of the APRP policy reform program, as well as regulatory and policy changes that were not part of APRP but affected the cotton subsector. It also includes specific policy recommendations.

ACKNOWLEDGMENTS

The principal investigator and author of this study is John Holtzman. He was ably assisted by Dr. Adel Mostafa of APRP/MVE, who has worked on the cotton subsector with the MVE Unit since 1997. Dr. Adel has managed all the field work on cotton trading, ginning and spinning since 1997. He has conducted numerous interviews with public and holding company officials, ginning and spinning company managers, private traders and exporters, and other key informants. Through his broad range of contacts, he was also able to assure access to difficult-to-obtain data. He has also provided valuable input and useful reviews of many MVE cotton/textile manuscripts.

Dr. Adel has managed several hard-working and reliable consultants to carry out field surveys and obtain certain types of secondary data, including the following:

- Nabil Sentricy, a cotton broker based in Alexandria, who has set up interviews with key officials and managers in the cotton lint trade and in the spinning industry
- Abdel Kader Ezz El Din, a Ph.D agricultural economist based in AERI/Zagazig, who has done numerous interviews with spinners and traders
- Mohammed Atwa, a Ph.D agricultural economist based in AERI/Beni-Suef, who has done numerous interviews with traders and producers
- Osama El Behnasawi, a Ph.D agricultural economist on the faculty of Al Azhar University, who has done numerous interviews with traders and producers.

Samar Maziad provided able research assistance. Yvonne Azer was responsible for text editing and final formatting of the report. Maggie Nabil assisted in table and graph creation. Dr. Gary Ender, MVE Chief of Party, provided several excellent reviews of report drafts.

The authors also wish to acknowledge Dr. Morsy Ali Fawzy of the MVE Unit for making available detailed tabulations of the data from a sample survey of 745 farms, carried out in October-November 2001. This data set is a wealth of valuable information about producers' cropping patterns, input use, crop disposal, and returns to alternative crops and rotations.

MVE also wishes to acknowledge the ongoing support and encouragement of Dr. Hussein Soliman, APRP Program Director, and Dr. Mohamed Omran of USAID's Competitiveness and Agricultural Development Division.

The MVE Unit benefitted from and continues to benefit from collaboration with the following organizations and groups:

- the MALR, particularly the Cotton Research Institute and the Economic Affairs Sector
- ALCOTEXA (Alexandria)
- the Domestic Cotton Traders' Committee
- CATGO (Alexandria)
- the Holding Company for Spinning, Weaving and Ready-Made Clothes
- managers of public, joint investment, and private spinning companies
- managers of private and public ginning companies

- managers of private and public cotton trading companies
- private seed cotton traders
- the APRP/RDI Unit, which has provided leadership in doing applied research and leading policy advocacy efforts in a number of areas in the cotton/textile subsector
- CSPP, the partially GTZ-funded Cotton Sector Promotion Programme implemented in collaboration with the MALR.

Individuals from these groups generously offered their time, provided detailed information, and answered numerous questions. Without the combined input of all of the aforementioned key informants, this study would not have been possible. The MVE Unit alone is responsible for any errors and omissions. The findings and conclusions of this study are those of the MVE Unit alone and not of APRP as a whole or USAID.

EXECUTIVE SUMMARY

The cotton/textile subsector is the most important subsector in the agricultural sector in terms of value of output, employment generated, and export revenue. As a major source of foreign exchange, cotton lint has earned an average of \$197.8 million per year from 1997/98 through 2000/01, while yarn has earned \$161.3 million per annum from 1999 to 2001. It is estimated that cotton production in Egypt employs up to one million farm workers, many of them hired workers used in a labor-intensive production process (including hand-picking of the crop). Employment in the ginning, cotton trading, and spinning industries combined for over 175,000 people in 2000/01.

Both the Agricultural Production and Credit Project (APCP) and APRP devoted major resources to reforming cotton subsector policies. Under APCP there were 29 policy benchmarks focused on cotton, initially on removing mandatory cropping pattern restrictions and increasing producer prices (share of world market price), and later on beginning to liberalize seed cotton marketing, ginning, cotton lint export, and the domestic trade in cotton lint. By the time APRP began in 1996/97, significant strides had been made on liberalizing Egypt's cotton economy, but important work remained to be done in completing the liberalization of cotton marketing, privatizing of state-owned ginning and spinning companies, and improving the competitiveness of Egyptian lint, yarn and textile product exports in world markets. Under APRP there were 36 policy benchmarks directly focused on the cotton/textile subsector and 17 benchmarks indirectly related to it. During the first three tranches of APRP (1996/97 through 1998/99), cotton was a major part of the APRP portfolio.

After 15 years of donor-supported work on liberalizing cotton marketing and privatization of public cotton/textile companies, significant progress has been made, but liberalization is not yet complete. During APRP the private sector has become well-established in seed cotton marketing, ginning, exporting, and spinning, with private market shares expanding over APRP in all these industries. Public sector market shares are still significant though declining in most of these industries. Yet the role of the GOE in setting prices and quotas, allocating market shares, and determining which varieties are grown in which districts are still key features of Egypt's cotton economy, which threaten to curtail further progress in market liberalization. The very gradual liberalization of the cotton/textile subsector over 15 years contrasts starkly with the rapid and decisive liberalization of the rice subsector over a much shorter period beginning in 1991/92. An indirect effect of differential rates of liberalization has been excessive allocation of scarce resources to rice production, milling and export. Nevertheless, policy reform in the cotton subsector has led to some impressive achievements.

APRP's Cotton Policy Reforms. APRP's cotton subsector benchmarks targeted the following areas:

- Market liberalization (6)
- Privatization (12)
- Yarn tariffs and export pricing (5)
- Phytosanitary requirements for lint imports (4)

- Short-season, short-staple varieties (4)

- Pest management (5)

Other benchmarks not specifically targeted to the cotton subsector included those designed to strengthen research and extension (5), market information (7), and export promotion efforts (5).

APRP Implementation Activities. APRP, with support from the GTZ-funded Cotton Sector Promotion Programme (CSPP), helped to move market liberalization forward. APRP and CSPP worked closely together to make the process by which the cotton varietal map is determined more transparent and market-driven. In addition, APRP examined the cotton pricing system in Egypt in 1996/97 and proposed a deficiency payment scheme for 1997/98, designed to increase private sector participation in seed cotton buying from virtually zero in 1996/97 while shifting the financial burden of the high producer support price to the GOE. APRP also analyzed cotton marketing costs and proposed ways to reduce these in order to make Egypt a more competitive exporter of cotton lint. Furthermore, APRP lobbied over the life of the entire policy program to increase private sector participation in seed cotton marketing, ginning, trading, export and spinning. In promoting cotton lint exports, APRP tried to eliminate administered prices at different levels of the marketing system, to rationalize and simplify the cotton grading system, and to introduce HVI testing of all exported lint cotton bales. Significant APRP efforts went into strengthening cotton production and marketing information, including implementation activities designed to improve cotton yield and area estimates, information on seed cotton prices, and information on the spinning characteristics of exportable lint cotton. Finally, APRP assisted the MPE/PEO to develop and use alternative privatization methods, including leases and management contracts.

APRP Strengthened Information, Analysis and Policy Debate. APRP itself was an excellent source of empirical information on the cotton/textile subsector, assembling and analyzing a vast array of secondary data, much of which was (previously) unpublished. APRP also generated new knowledge through formal surveys of cotton producers, seed cotton traders and private spinners, as well as structured informal interviews with many subsector participants, including managers of ginning, trading/exporting and spinning companies. By the end of APRP, the MVE Unit had developed and refined an internally consistent set of key monitoring indicators on output/throughput, earnings, and employment on seed cotton trading, ginning, and lint/yarn exports (see MVE Monitoring Report No. 4, 2002) that covers the period from 1990 through 2001. These indicators focus on aggregate output and export earnings, as well as public and private shares.

APRP used the empirical information from its formal surveys, informal interviews, and analysis of secondary data to raise the level of analysis and debate on cotton subsector issues to a much higher level. APRP introduced rigorous economic analysis of production and marketing costs, prices, and returns, subsector structure and performance, and Egypt's export performance and competitive advantage. Better information and economic analysis enabled APRP to challenge unquestioned assumptions about the Egyptian cotton subsector, stimulate a constructive dialogue between the public and private sectors, and serve as a neutral broker in policy debates involving various stakeholders. In this process, the private sector became better able to articulate its policy views and carry out advocacy efforts. Private sector participants' understanding of world markets and technology options was also strengthened.

Mixed Results of APRP. Not all APRP efforts were immediately successful or achieved the desired impact in the short run. APRP work on clarifying MALR/CAPQ's phytosanitary rules

regarding lint imports and encouraging importation of foreign short- and medium-staple cotton lint (that was far cheaper than Egyptian fine cotton) led, with a lag, to expanded imports that provided some Egyptian spinners with cheaper raw material. APRP efforts to promote *hirsutum* cultivation met with some resistance, though by 2000/01 it was clear that Egypt's short- to medium-run strategy for obtaining cheaper short-staple cotton should be to import (subsidized) foreign lint rather than allocating scarce irrigated land to *hirsutum* production. The fact that both approaches were used simultaneously by APRP is a good example of the flexibility of the APRP/RDI in using two different tactics (simplify importation of lint; promote *hirsutum* cultivation) to pursue the same strategic objective (providing Egyptian spinners with cheaper raw material).

APRP support to MPE and the textile holding companies on privatization had mixed results. As APRP began, two public ginning companies were privatized through stock market flotations; groups of anchor investors bought up controlling blocs of shares. One ginning company, Arab Ginning, became an industry model for introducing new cleaning, ginning, and baling technology at its gins. It also closed several uneconomic gins in congested urban areas, set up a couple of new gins on new (rural) land, and reduced its inflated labor force through a self-financed early retirement program. Ginning industry privatization encouraged private and public ginners to compete on the basis of quality and timeliness of ginning services, and factors such as the availability of improved cleaning lines and UD bale presses at particular gins became important determinants in cotton traders' (particularly exporters') choice of gin.

Unlike the ginning industry success, APRP was unable to make any progress in privatizing public sector cotton trading companies, which continue to dominate seed cotton marketing (along with the Horticultural Services Unit, another public entity) yet whose export market shares have declined. Vigorous APRP efforts to privatize spinning companies supported the MPE early during the APRP program (1996-1998) in selling two companies via stock market flotations, arranging three long-term leases, considering the use of management contracts, and actually liquidating a handful of poorly performing textile companies. By 1999, however, textile and ginning industry privatization had completely stalled, and no additional progress was made under APRP. Independently of APRP, the textile holding company signed three management contracts with foreign management consultancies, but the results were disappointing, and the contracts canceled after a short time.

General Lessons of Cotton Policy Reform. A general lesson from APRP's experience in trying to promote cotton subsector reform is that reaching consensus among subsector participants with divergent interests is difficult. This has led at times to very slow or uneven progress on some policy reform fronts, which have threatened to undermine the longer-term liberalization process.

Furthermore, making piecemeal reforms can lead to modest incremental improvements, but there is need for a more comprehensive strategic vision. Note that CSPP is currently working closely with MALR to develop such a vision and long-term program for implementing the selected strategy. In addition, granting special favors to particular entities, such as the HSU's assembly of about 20% of the seed cotton crop during the past two market years, can be counter-productive and discourage private sector participation in the marketing system. Another policy reform process lesson from APRP is that a mix of specific policy reform benchmarks and discrete, feasible implementation activities is a good way to keep liberalization moving forward. During some periods policy reform benchmarks may not have been fully accomplished, or, in some instances, they were struck down in the policy reform design process because one or more key stakeholders did not support particular measures. The RDI Unit played a very effective role

in considering the optimal time to introduce policy benchmarks, while shifting to implementation activities and quietly building behind-the-scenes consensus for reforms when the time was not ripe for proposing benchmarks. Simply getting some policy issues on the reform agenda sometimes proved to be key, despite initial rejection of new ideas. Raising the issue, marshaling industry support for reform, identifying a technocrat in the GOE or leading industry figure who would champion the reform, and providing him with sound economic analysis could lead, over time, to successful reform efforts.

The Egyptian cotton/textile subsector is now at a critical crossroad. Substantial progress has been made in liberalizing cotton marketing and export, but the privatization process has faltered and stalled. Public cotton trading companies continue to dominate seed cotton marketing (through the PBDAC-run sales rings), public ginners gin 58-67% of the seed cotton crop, and public and joint investment spinners produce 60% of total cotton yarn output, although private sector shares have expanded in all three industries during APRP. Further progress may hinge on the GOE's willingness to privatize remaining public cotton trading, ginning and spinning companies, despite the political risks involved in tackling thorny issues such as redundant labor, overly high valuations of public companies' assets, and liquidating excess capacity, either idled or outmoded. In addition, GOE willingness to abandon the remaining administrative allocation and pricing systems, which still largely determine which cotton varieties are grown (and ginned) where, the level of prices at most levels of the marketing system, market shares in assembling seed cotton, allocations to gins (and ginning charges levied), and allocations to public spinning companies (and lint prices paid by spinners), is critical to ensuring the long-run success of the liberalization process.

Future Policy Reform Agenda. As APRP comes to a close, the MVE Unit makes the following specific policy recommendations. The GOE, with support from the donors and cotton industry advocacy groups, should:

- Make the process by which the cotton varietal map gets determined each year more open and transparent. The varietal committee dominated by MALR officials should include industry representatives, both public and private.
- Strengthen the role of the domestic cotton traders' committee (or union) in allocating seed cotton market shares (through the PBDAC ring system) and in defending the right of private (and cooperative) entities to establish their own buying points, independent of the PBDAC-run system.
- Consider dropping the one buyer per PBDAC ring requirement and opening PBDAC rings up to competition. Critically review the cottonseed multiplication, collection, and distribution process, with an eye toward greatly reducing cotton area planted to meet seed requirements and greatly scaling back the role of HSU.
- Revive privatization efforts in the cotton trading, ginning and spinning industries. Set a goal of privatizing at least one public cotton trading company per year over the next five years. Offer individual gins of public ginning companies for sale or lease, rather than offering entire ginning companies (with massive, costly assets) for sale. Use triage to tackle public spinning industry problems; liquidate the most problematic and poorly performing companies as soon as possible; provide selective financial, management and technical support to companies that can be made salable with restructuring; offer the

best-performing public spinners for sale or lease on more favorable terms to foreign investors, joint venture partners, or private domestic industry leaders.

- Encourage ALCOTEXA to abandon completely its system of minimum export prices and exportable grades. As APRP/RDI and CSPP have pointed out in numerous papers and presentations, all Egyptian *barbadense* cotton is exportable, whatever its variety and grade, provided there is complete export pricing flexibility.
- Encourage TCF to abandon minimum yarn export prices and improve its capacity to analyze and present different estimates of spinning costs by type of industry participant, so as to counter any dumping allegations from industrial countries.
- Continue to promote the export of Egyptian cotton lint, yarn, fabric and RMGs and refrain from establishing quotas that limit exports of particular lint varieties.
- Continue to strengthen domestic capacity to collect, analyze and interpret production and market information on the domestic cotton market and world markets. Furthermore, ensure that information and analysis be more widely disseminated to a broad range of public and industry audiences. Support the further development of various web sites and other means to disseminate market information quickly, widely, and more effectively than in the past, when access to good market information was the preserve of a handful of public officials and well-placed representatives of the private sector.

Importance of Continuity. In conclusion, the GOE has made impressive progress to date, with APCP and APRP support, in reforming the cotton subsector in Egypt. Liberalization is not yet complete, however, and the GOE needs to avoid any back-sliding or immobilizing inertia that paralyzes future reform. The MVE Unit recommends strongly that USAID and other donors, notably GTZ, keep cotton policy reform on the agricultural policy reform agenda in any future policy and market reform programs in Egypt.

1. INTRODUCTION

In the fall of 1997, the MVE Unit decided to undertake a series of subsector studies, using a structure, conduct, performance approach. During 1998 and the first half of 1999, four baseline studies were conducted by MVE staff and consultants. One of the key subsectors chosen was cotton, an important summer field crop and a major source of foreign exchange earnings from exports. MVE began the *Cotton Subsector Baseline Study* at the end of the 1997/98 marketing season and completed it early in the 1998/99 season.

The *Cotton Subsector Baseline Study* was followed by annual updates for 1998/99, 1999/00, and 2000/01, done by MVE, CSPP or both. These updates captured many of the details of how the Egyptian cotton market was changing year by year in response to APRP benchmarks and initiatives, as well as to developments in the broader Egyptian economy and world markets. Both the baseline and the updates drew heavily from a broad range of published and unpublished data sources, synthesizing this information into an integrated picture of the evolving cotton/textile subsector in Egypt. In addition, MVE undertook two original and seminal studies of the impact of privatization and policy reform on both the ginning and spinning industries in Egypt. Both these studies were well-received and generated new knowledge about two important industries in the cotton subsector, where considerable privatization, private investment and progress were made. MVE also assessed interim *Progress in Cotton and Rice Subsector Liberalization and Privatization* (November, 2000), which categorized policy benchmarks and discussed their achievement and impact. Finally, MVE has recently completed a review of privatization progress and obstacles in both subsectors (see Maziad, 2002).

This *Cotton/Textile Subsector Endline Study* is a final review of key APRP policy benchmarks and implementation programs that affected the cotton subsector. It also examines changes over the life of APRP in the structure, conduct and performance of the subsector. The *Endline* also offers policy recommendations and suggestions for future applied research and monitoring. The *Endline* is not meant to be an exhaustive treatment of all the topics that APRP has covered on cotton market reform. The interested reader is referred to the earlier MVE, CSPP and RDI reports for details about particular production and marketing years and policy measures, whether APRP-related or not, and their specific impacts on the cotton subsector.

2. THE COTTON SUBSECTOR AT THE BEGINNING OF APRP

2.1 Reforms under APCP and Implementation Progress

The Agricultural Production and Credit Project (APCP) undertook a series of policy reforms, beginning in 1986/87, that changed the cotton subsector in fundamental ways. The major reforms were to remove crop area controls and to start offering farmers a higher percentage of the cotton export price. Some work was also done to reduce subsidies on pesticides used in cotton production.

By the early 1990s, the stage was being set for liberalization of cotton marketing. In 1994 three laws were passed which enabled any public, cooperative or private entity to enter the seed cotton trade, to join ALCOTEXA and become an exporter of lint cotton, and to re-establish the bourse at Mina al Bassal. 1994/95 and 1995/96 marked the first two years of cotton market liberalization, in some ways a big success and in some ways disorderly. As 147 companies registered to trade seed cotton, private sector participation in the seed cotton trade went from zero to an estimated 53% in two short years. Private companies joined ALCOTEXA and began to export modest quantities of lint cotton. Several private cotton trading companies leased gins from public sector ginning companies and ginned 25% of the cotton crop by 1995/96.

Given the short cotton crop in 1995/96 and the eager private sector participation in buying the crop, prices shot up during the first half of the marketing season and led the GOE to declare a buying freeze. This ended up disrupting the market and led many private buyers to lose money when they ended up selling their cotton to public sector trading companies after the freeze. Public ginning and trading companies reported that some of the seed cotton delivered to the gins was mixed (more than one variety), adulterated (containing too much foreign matter), and of poor quality.

Note that while the cooperatives had dominated seed cotton assembly (buying an estimated 87% of the crop as first handlers from farmers) in 1994/95, the cooperatives' share dropped sharply to an estimated 17% in 1995/96 and the PBDAC rings were established to buy up most of the crop. The Field Crop Marketing Cooperatives basically dropped out of the market in 1996/97, not to reappear before 1999/00. The PBDAC ring system became firmly entrenched in 1996/97, when most of the crop (13%) was assembled by the six public trading companies and four public ginning companies. While an increasing number and proportion of the PBDAC rings were allocated to private trading companies from 1997/98 through 2000/01, the PBDAC ring system became a mechanism for controlling access to the seed cotton market and discriminated against the private sector, particularly smaller private traders, and the Field Crop Marketing Cooperatives.

2.2 Limited Private Sector Participation in 1996/97

After the initial widespread private sector participation in seed cotton marketing in 1994/95 and 1995/96, the private sector essentially disappeared from the market in 1996/97. The PBDAC ring system was only indirectly responsible for this. The main reason was that seed cotton

prices, declared before planting,¹ ended up being too high by harvest time relative to world prices, which declined steadily and sharply during the first half of 1996. By harvest time, seed cotton was priced at levels that exceeded lint cotton equivalent export prices. Private traders exited the market, while the public trading and ginning companies dominated deliveries to the gins. The halcyon, heady days of early cotton market liberalization were over. APRP began on a far more sober note. The fact that price policy undercut private market participation was ironic, as USAID had pushed the GOE to raise producer prices to world market levels. The GOE overshot the mark by a wide margin in 1996/97, largely because world prices had dropped so sharply following announcement of high producer prices before planting. The impact of announcing high grower prices was disastrous. Public trading companies bought most of the crop and accumulated sizeable debts. They also dominated lint exports. The private sector largely withdrew from the domestic seed cotton and lint export markets.

While market liberalization faltered in 1996/97, there were some privatization successes. Two ginning privatizations were completed. Three privatizations of textile companies were well underway, with two reaching greater than 50% ownership shares by groups of private investors. The private sector also continued to gain some experience in exporting lint, obtaining lint from public trading companies.

The price policy error of 1996/97 led to implementation of a deficiency payment scheme in 1997/98, proposed by APRP/RDI and supported by the industry and the Cabinet. This led to modest private sector participation in seed cotton buying, starting the private sector back on a path of increased participation during the next several years.

To summarize the status of market liberalization in 1996/97, we note that this season represented a step backward in the process:

- Field crop marketing cooperatives had disappeared from the seed cotton market.
- Private sector market shares plummeted in the seed and lint cotton trade.
- Seed cotton prices were fixed at a high level during 1996/97. Although technically minimum producer prices, they were set at levels that discouraged private participation in the seed cotton trade.
- Public companies delivered essentially the entire seed crop to the gins and accumulated massive, unsold inventory that was transferred to the GOE by the end of the marketing season. Carryover ballooned to excessive levels and remained a problem, with serious financial consequences, for the next several years.
- Private exporters' shares remained modest, as they depended almost entirely on public trading companies for their lint.
- Ginning companies set a fixed ginning rate, with the approval of the holding companies, and the allocation of seed cotton to the gins by public trading companies was largely determined administratively.
- Public spinning companies dominated the spinning industry, operated under holding company orders, and were allocated lint by an allocation committee comprised of holding company officials and heads of large public sector spinning companies.

¹ Note that the GOE has not typically announced producer seed cotton prices before planting. 1996/97 was exceptional in that regard. During many years, producers do not learn of seed cotton prices until harvest or near harvest.

- Private sector trade in seed cotton was set back by the administrative allocation of PBDAC sales rings to public trading and ginning companies, whereby only one buyer could receive and purchase seed cotton at a ring. This discouraged competition.

Fortunately, the situation could only improve during the remaining years of APRP, and it did improve. This story and APRP's role in this process will be discussed in subsequent sections.

3. COTTON SUBSECTOR POLICY BENCHMARKS UNDER APRP

The cotton/textile subsector was the subject of 54 policy benchmarks under APRP, of which 37 were directly targeted to the subsector and 17 were designed to strengthen support institutions and services. The number of benchmarks per tranche, by category, are shown in Tables 3-1 and 3-2.

Table 3-1: Classification of Cotton/Textile Subsector Benchmarks under APRP

Benchmark Category	Tranches					Total
	I	II	III	IV	V	
Cotton Market Liberalization	2	2	1		1	6
Privatization of Public Textile Companies	5	3	4			12
Yarn Tariffs & Export Pricing	2	1	1		1	5
Phytosanitary Restrictions on Lint Cotton Imports	2	1	1			4
Short-Season & -Staple Varieties	2	1	1			4
Pest Management	1	1	1	2		5
(Acid) Seed Delinting	1					1
Total	15	9	9	2	2	37

Source: Annual APRP MOUs.

Several things are interesting about the breakdown and temporal distribution of cotton benchmarks over APRP. First, the large number of benchmarks (n=12) related to privatization includes measures designed to prepare public companies for privatization, such as reducing debt and inventory, rather than merely benchmarks that stated that 1-3 companies of particular industry had to be privatized. Second, Table 3-2 shows benchmarks that did not target the cotton subsector but rather cut across commodity subsectors.

Third, 90% of the benchmarks directly targeted to the cotton subsector (33 of 37) were found in the first three tranches. Midway through APRP, USAID opposed any new cotton benchmarks, perceiving that significant USAID resources had already been earmarked for cotton policy reform and protesting that several proposed Tranche IV benchmarks sounded very similar to benchmarks in the previous three tranches. In essence, USAID was saying that it had already “bought” a lot of policy reform under APCP and APRP, and why should it continue to pay more (tranche) money when reform in other commodity subsystems, water resource management, and support services and institutions required financial support. Donor fatigue with programs that achieve slow and incremental results is not uncommon. Defending USAID’s perspective, policy reform in the cotton subsector can be perceived as ultra-gradual or infra-marginal. Despite millions of dollars in tranche monies earmarked for cotton policy reform and market liberalization, the results have been quite modest to date.

Table 3-2: Classification of Cotton Subsector Benchmarks under APRP: Support Institutions and Services

Benchmark Category	Tranches					Total
	I	II	III	IV	V	
Research and Extension	1	1	1	1	1	5
Improving Market Information	2	2	0	1	2	7
Commodity Associations/Promotion			1	1	3	5

Source: Annual APRP MOUs.

Notes: 1) Tranche V, D7 (e-trade) is classified under yarn export pricing.

2) Tranche III, B3 (2000 new jobs) is classified under privatization.

3) Pest management includes benchmarks about pesticide registration/licensing and harmonizing of registration/labeling.

4) Tranche V, D3 (cotton logo) is classified under Commodity Associations/Promotion.

5) Tranche V, D2 (HVI testing) is classified under Improving Mkt. Information.

6) Research and Extension benchmarks were general and not targeted to cotton.

7) Most of the support institutions/services benchmarks were general and not specific to cotton.

In defense of the GOE, the gradual pace of reform was necessary, given the economic importance of the cotton/textile subsector, the number of jobs downstream that depended on cotton (in trading, ginning, spinning, weaving, and other textile manufacturing), and the minefield of stakeholders and special interests that precluded achieving any consensus on a policy reform agenda. Given the diversity of stakeholders and interests, it is probably fair to predict that any effort to craft a subsector strategy and action plan is doomed to fail. One or more interest groups will be hurt under any strategy and will block its implementation. Public sector companies, with large numbers of employees, strong unions defending those employees, and a huge installed asset base, will be hurt under any reform scenario and hence oppose any strategy designed to reduce their numbers (through liquidation or rapid privatization), their preferential access to finance or subsidies, or their influence. No one strategy, however carefully crafted, will make everyone happy.

In defense of USAID's continued funding of what appears to be very slow and partial cotton subsector liberalization, the private sector had been strengthened to the point by 2001/02 where market liberalization was irreversible. GOE fiscal straits and tight liquidity will lead to lower levels of support and subsidization of money-losing public companies. The public sector commercial banks are approaching the point where they are refusing to provide new loans to public traders and spinners. Financial crisis will lead to draconian measures to pare down poorly performing public companies, particularly in the textile industry. As the 2001/02 marketing season ends with high levels of lint carryover and public company debt, GOE business as usual cannot be continued. Financial exigencies will force change, whether the Holding Company and public affiliated companies are ready for it or not.

4. APRP IMPLEMENTATION ACTIVITIES

In addition to many benchmarks affecting the cotton/textile subsector, APRP participated in a series of implementation activities which complemented, and in some cases went well beyond, the formal policy benchmarks. These implementation activities included the following:

- APRP lobbied the GOE to free cotton prices at different levels of the marketing system. At the same time, APRP advised the GOE to adopt a deficiency payment scheme in 1997/98 to cover the difference between the high domestic seed cotton price and the lower international lint export price. This was designed to provide an incentive for the private sector to remain involved in the cotton trade, despite the GOE pricing policy and difficulties.
- APRP analyzed ways to reduce cotton marketing costs, advocating elimination of *farfarra* in Alexandria, as well as pressing of lint cotton in universal density (UD) bales at the gins. By bale pressing at the gins for direct export, several cents per lb. are economized off of fobbing costs.
- APRP lobbied the GOE for broader participation in seed cotton marketing, including buying by private traders at PBDAC rings and outside those rings, as well as by cooperatives.
- APRP, with support from CSPP, lobbied the cotton varietal committee of MALR for changes in the varietal map after the sudden cancellation of Giza 75 in 1998. Vigilant APRP intervention in 1999/00 led the committee to reconsider phasing out Giza 70, a high-yielding ELS variety, which was considered in “low demand” because carryover stocks had piled to very high levels following marketing seasons when ALCOTEXA set the Giza 70 price too high.
- APRP promoted lint cotton exports through encouraging market-based pricing, simplified grading (and price differentials across grades based on market demand rather than fixed, administered intervals), HVI testing of export lots, and development of the Egyptian cotton logo. Promotion of the logo was passed to CSPP after an initial APRP push.
- APRP strengthened market information on the seed cotton market in two ways. First, as a user and consumer of cotton market information, APRP demanded timely and improved information. Second, APRP provided technical assistance and some financial support to MALR/EAS to collect and publish seed cotton price information during the 1997/98 marketing season. Third, APRP developed a web site of selected statistics on cotton and rice production, prices and exports on www.agpolicy.com that has been transferred to MFT’s Research and Development Sector and is now available at www.egyptinc.com.
- APRP’s MVE Unit worked closely with MALR/EAS to develop an improved method for forecasting cotton yields (2000/01) during the growing season. This was actually implemented in 2001/02. MVE also helped MALR to improve its estimates of area planted to seed cotton and other field crops.

- APRP's RDI Unit assisted the MPE/PEO in developing privatization methods other than sales to anchor investors or stock market flotations. The most notable achievement here was in helping PEO develop and issue guidelines for leasing and management contracts in 1999.

APRP collaborated very effectively with the MALR/GTZ Cotton Sector Promotion Programme (CSPP). The two programs complemented one another, with APRP focused more on policy and CSPP focused more on technical areas in cotton production. APRP concentrated on cotton market liberalization, trade policy reform (on both imports and exports), privatization, and promotion of private investment. CSPP had several technical advisors working on issues such as the effectiveness of the extension service in promoting cotton production, cotton agronomy, pesticide use in cotton production, and expanded planting of delinted seed (particular acid delinted seed). Both programs collaborated successfully in the following activities:

- Reviewing the cotton grading system and seed/lint cotton quality issues.
- Annual reviews of the cotton marketing system decrees (the Optional System) and actions to ensure the broadest possible participation in seed cotton buying.
- Review of the annual varietal map and proposed recommendations to expand area to promising varieties.
- Developing the cotton logo and promoting its use under license to ALCOTEXA.

Implementation of various cotton subsector activities and work on developing policy benchmarks greatly improved understanding of the cotton production, marketing and processing system. In addition to being major consumers (and demanders) of cotton production and marketing information, APRP and CSPP generated, analyzed and synthesized far more detailed information than previously available about cotton yields, production practices, seed cotton buying, lint cotton trading, domestic spinning, and the world market for fine cotton lint (long-staple and extra-long staple). Several methods were used to generate this information and analyze it in a way that improved the cotton subsector knowledge base:

- Sample surveys of cotton growers, traders, and spinners.
- Periodic structured informal interviews with cotton trading companies, selected public, joint investment and private spinners, and holding company, CATGO, TCF and MALR officials, and other key informants.
- Detailed economic and financial analysis of the competitiveness of yarn production of different counts by domestic spinners, using different types of raw material (different Egyptian lint varieties vs. cheaper imported short-staple lint).
- Partial equilibrium modeling (1997) of the impact of export and seed cotton pricing policies on cotton output, domestic utilization and lint export sales.
- Linear programming optimization modeling of the best varietal mix in Egypt, using secondary cotton yield data and alternative pricing levels.

Probably the greatest intellectual contribution of APRP (and CSPP) was its frequent challenging of often false conventional wisdom. It questioned unchallenged assumptions. As an example, officials in public sector trading companies insisted that *farfarra* in Alexandria by the Alexandria Pressing Company, a public company, was a requirement of buyers of Egyptian lint. In some cases, foreign buyers prefer this *farfarra*, but in other cases they do not and reacted positively to the cost savings made possible by UD press baling at upcountry gins. In 1996/97, the

ALCOTEXA Mangement Committee, led by public sector trading company chairmen, adamantly opposed introduction of UD baling, which actually was introduced late that marketing year on a trial basis. By 2000/01, probably over half of all export bales were pressed at the gins and exported directly, resulting in cost savings.

Another example of how outdated information and misleading conventional wisdom influenced cotton subsector policy is holding company estimates of domestic lint requirements. The conventional wisdom at the beginning of APRP was that domestic spinners required at least four million lint kentars of Egyptian cotton. While domestic utilization was indeed four or more million lint kentars per year from 1994/95 to 1997/98, it began to fall steadily after that, dropping to an estimated 2.7 mlk in 2000/01.² The perception that 4.0 mlk were required by domestic spinners no longer reflected reality by the end of the 1990s, though the holding company insisted in 2000/01 that 4.0 mlk needed to be reserved for domestic use. This led the HC, MEFT and MALR to impose quotas on lint export, particularly for long-staple varieties such as Gizas 85, 86 and 89. Exports in 2000/01 were lower than they could or should have been that season, as ALCOTEXA and the GOE sent foreign buyers the wrong signals early in the export marketing season (fall 2000) about the strength of domestic demand for long-staple varieties and available levels of LS lint for export.

Although APRP's questioning and challenging of assumptions undoubtedly annoyed many GOE, HC and public company officials, it did improve the quality and level of the policy debate on cotton. It helped to stimulate a constructive dialogue between various GOE entities and private sector representatives (of several industries, including trading, ginning and spinning). While APRP may have been perceived by some individuals in the public sector as championing the private sector, regardless of the consequences, most participants in the policy debates realized that APRP was a neutral broker that saw the big picture and worked tirelessly for an improved and more competitive cotton marketing system, as well as a strengthened domestic spinning industry. It is not clear who will play this role once APRP is over; one hopeful sign of continued dialogue is the ongoing cotton subsector strategy exercise involving the MALR, the High Cotton Council and CSPP. This began early in 2002 and is slated for completion by the end of the year.

² Note that an estimated 575,000 lk were imported in 2000/01 for use by domestic spinners. Added to 2.7 mlk of Egyptian lint, domestic utilization that year was actually closer to 3.3 mlk.

5. APRP SUCCESSES AND THEIR IMPACTS

This chapter highlights several of the more successful APRP benchmarks and implementation activities.

5.1 Cotton Market Liberalization

After an uneven start to the liberalization process in the mid-1990s, and the virtual sidelining of the private sector from seed cotton buying and lint trading in 1996/97, considerable success was achieved in market liberalization by 2001/02. As noted in the previous chapter, strong economic analysis supported the market reform process throughout APRP. This raised the level of public discussion of key issues about needed reforms, their sequencing, and their probable impact. The APRP/RDI Unit and CSPP were not private sector ideologues; rather, they were sensitive to Egypt's need to proceed very cautiously and gradually in liberalizing a subsector ridden with controls and parochial interest groups.

Probably the greatest achievement of the policy benchmarks focused on market liberalization was support to private traders and cooperatives to set up their own seed cotton collection points. This broke the virtual monopoly of PBDAC and the Cotton Marketing Supervisory Committee, chaired by the head of PBDAC, in allocating cotton buying rights and locations. By 2001/02, the PBDAC ring system was still firmly entrenched, but there were record numbers of private "rings" and collection points. MVE anticipates that more private buying points will be established in the future, now that it is clear that CATGO is committed to grading seed cotton at any buying point in Egypt that applies for CATGO grading services. As late as September 2000, there was uncertainty over whether CATGO would provide seed cotton grading services at private rings or outside gins. Once Ministers Youssuf Wally and Youssef Boutros Ghaly threw their support behind the right of private traders to establish their own buying centers and CATGO's obligation to grade their seed cotton in late September 2000, this principle has not been questioned. It is now GOE policy.

APRP and CSPP worked closely with private sector exporters to develop a strong countervailing force against the holding companies and their affiliated cotton trading companies, who completely dominated seed cotton marketing in 1996/97. APRP economic analysis supported the advocacy efforts of these leading private trading companies (who supply both the domestic and export markets, though increasingly the latter). APRP and CSPP international market studies for lint and yarn improved private and public participants' understanding of world cotton markets and Egypt's high-end niches in those markets. Study tours, special studies, and visits by qualified technical consultants to Egypt provided leading private trading and ginning companies with better knowledge of ways to improve their technical efficiency (through better cleaning of seed cotton, reduction of contamination), their economic efficiency (by using UD bale presses at gins, which lowered marketing costs), and their competitiveness (by improving the quality of their fine cotton products) when faced with stiff international competition by lower-cost, yet lower-quality fiber, albeit generally with less contamination.

5.2 Some Exogenous Factors Contributing to Cotton Market Liberalization

While APCP and APRP played important roles in reforming the cotton subsector, they are not due all the credit. Over the course of APRP, the private sector gradually grew stronger and developed its own voice and advocacy skills. Up until January 1998, public sector companies completely dominated ALCOTEXA's Management Committee. Private representation expanded in 1998-2001, but private trading companies did not dominate ALCOTEXA until January 2001, at which point three of four officers were elected from the private sector and the private sector enjoyed numerical superiority on the Management Committee.

Another important exogenous factor was the devaluation of the Egyptian pound in two major steps in August 2000 to \$1.00 = LE 4.15 and December 2001 to \$1.00 = LE 4.51. This worked to the advantage of private lint exporters, who were allowed to convert dollars earned on exports to Egyptian pounds at an open market exchange rate. In contrast, public cotton trading companies had to convert their foreign exchange earnings into pounds at the official rate. The effect of an increasingly strong dollar was to decrease seed cotton prices in dollar terms. This allowed exporters, particularly private companies, to reap windfall gains on exports of lint. Alternatively, private exporters were able to discount their lint deeply, which enabled them to capture significantly greater market share in both 2000/01 and 2001/02. Public trading companies, bound by Central Audit Authority accounting rules and forbidden by the holding company and MPE to sell any lint at a loss, could not offer deep discounts. As a result, private exporters had captured about 70% of the exported lint market share in 2001/02.

Devaluation of the Egyptian pound vis-a-vis the dollar also enabled Egyptian yarn exports to bounce back somewhat in 2000 and 2001 after a steady slide in the volume and value of yarn exports from 1994 to the nadir of 1999. This decline can be attributed in part, particularly after 1997, to the devaluation of the currencies of Asian competitors in world yarn markets.

5.3 Improving Cotton Market Information

This proved to be a daunting task, as the GOE had historically not released cotton market information widely nor in a timely manner. Much work still remains to be done in this area. Despite the unfinished task, APRP did become a valuable source of market information and analysis, which was made available to anyone interested.

APRP encouraged CATGO to publish its weekly bulletins of the cotton marketing situation. It also assisted CATGO to add data on HVI test results on export lots of lint cotton to its web site at <http://www.egyptcotton-catgo.org/index.html>.³ APRP urged CATGO to expand its distribution of hard copy bulletins to a wider audience, which it did do in 2001/02. Still, fewer than 100 individuals receive copies of the bulletins; this group includes MALR and HC officials, heads of public trading and ginning companies, heads of larger private export companies, selected academics, and some newspaper/magazine reporters. APRP advised CATGO to post

³ The HVI test results for the first 5-6 months of 2001/02 were reported on a temporary web site.

as much as possible of the weekly marketing report data on its web site, but this had not yet been accomplished as of August 2002.⁴

Early in APRP, the RDI Unit worked closely with MALR/EAS to obtain international market information from leading websites (FAO, USDA, ICAC). This information was downloaded and put in quarterly situation and outlook reports. Unfortunately, MALR added little value to this world market information and made little attempt to link it to the domestic market situation.

The MVE Unit worked with MALR/EAS over two production seasons to develop a method for forecasting of seed cotton yields during the growing season. As the improved methods to estimate yields were being implemented in the field, MALR shifted its attention to improving area estimates for key field crops, including cotton. MVE also assisted with this work.

ALCOTEXA established its web site in 1999, to which it has posted weekly market reports, consisting of a series of spreadsheets that detail the volume of export sales for the week and for the season, by variety, exporter, export destination and buyer. The estimated value of those export sales commitments (where shipments lag commitments during the marketing year) is also calculated per variety by exporter, based on official minimum export prices. APRP provided little impetus to this effort. ALCOTEXA actually began issuing hard copies of several EXCEL tables each week in 1996/97. Putting this information on its website simplified distribution and lowered its cost. Whether more cotton market participants are able to access this data is not clear. Cotton traders would need electricity (widespread), a PC and modem (not so widespread outside Cairo and Alexandria), an ISP (typically based in Cairo and Alexandria and hence a long-distance call for traders outside those metropolitan areas), the program EXCEL, and the expertise to use all of the above. ALCOTEXA does not keep counts or detailed information about internet “hits” by user type, but it is likely that few domestic cotton traders consult ALCOTEXA’s web site. Nevertheless, over time this will change as PCs and internet cafés become more widely used, even in Upper Egypt.

A final internet-based innovation worth mentioning is the RDI Unit’s attempt to develop a cotton web site (initially on www.agpolicy.com), which has been transferred to MFT’s Research and Development Sector (now available at www.egyptinc.com; follow the link to Egypt Marketing Information System). The commodities covered include cotton and rice (sub-sites developed by APRP) and melons, strawberries, grapes, and mangoes (developed by ATUT). The cotton sub-site covers export prices of Egyptian lint, compared to U.S. pima, production of Egyptian lint varieties and pima in the U.S., and supply and use during 2001/02. There are some errors in the data presented, particularly in the supply and use table.⁵

⁴ One table, appearing in the weekly marketing reports, is available at the CATGO web site. It covers the “statistical position of Egyptian cotton during the 2001/02 marketing season.” This summarizes, by variety, carryover stocks at the beginning of the season, production, total stocks (carryover + production), exports, deliveries to domestic spinners, and remaining stocks as of the most recent reporting week.

⁵ The supply use table (see carryover) on the cotton sub-web site shows Giza 75 as having the largest available supply, when the last year it was produced was 1998 ! Several of the estimates for cotton production (particularly for Giza 80/83) appear to be several orders of magnitude off. There is reportedly no supply of G-80/83 left, which contradicts the data on CATGO’s web site that indicate remaining stocks of 158,178 lk of Giza 80 and 176,916 lk of Giza 83.

MVE's main concern about market information enhancements is sustainability. MALR capacity to do economic analysis of production, market supply, price and trade data is limited. Incentives to do timely, thorough analysis are completely lacking. Cotton policy has historically been made by the Minister of Agriculture and Land Reclamation in consultation with a small group of key decision-makers in MALR and ARC; price levels at different points in the marketing chain have been set administratively. Although the circle of decision-makers who set cotton marketing and price policies is wider than it was ten years ago, it still seems that such decisions are the prerogative of a tight, inner circle who give lower priority to economic analysis. The key question is whether senior GOE policy-makers want and demand timely and accurate market information, and what they are willing to pay to get hold of such information when needed.

As hinted earlier, dissemination of MALR and CATGO data and reports is not wide enough. CATGO's weekly reports are issued on a timely basis, though distribution is limited. MALR, MPE, holding company, and PBDAC data are treated as proprietary and often only released after they are no longer of any trade value to the private sector. For example, cotton area estimates may not be made available until well after harvest, and even then they are considered preliminary and subject to ministerial review and adjustments. ALCOTEXA export data are probably the most accessible, thanks to a well-functioning MIS Unit and website, which is updated in a timely manner. ALCOTEXA has the funds to maintain and strengthen its web site, as well as an apparent interest and commitment to doing so. The same cannot be said for CATGO, MFT, and MALR. Without continued APRP support, it is not clear whether these web sites will be sustained.

5.4 Facilitation of Lint Imports

Five benchmarks were devoted to this objective in Tranches I through III of APRP. These benchmarks provided technical assistance for and pushed MALR/CAPQ to consolidate and clarify phytosanitary rules governing lint imports. After the conclusion of Tranche III, it did not appear to MVE that enough had been accomplished to consider this a success. Costly double fumigation and flying of MALR inspectors to shipping countries (and their ports of embarkation) appeared to be hard-and-fast requirements that added significant cost to importing cheaper lint. Actual imports of foreign lint were disappointingly low in 1996/97 through 1998/99, largely because large Egyptian cotton crops and massive lint carryover led the holding companies to discourage imports. The short cotton crops of 1999/00 and 2000/01 changed the domestic supply situation, however, and imports expanded quickly to fill domestic shortfalls. A prime consideration propelling imports was relative prices, however. Egyptian lint, already expensive raw material for domestic spinners who spun largely low- to medium-count yarn, became relatively more expensive than shorter-staple cotton grown in Greece, Syria, Sudan and the U.S. With such large price differentials, the economic incentive to import cheap foreign lint was too great. The holding company became the main importer of first Greek medium-staple cotton in 1999/00, and later Syrian short-staple lint in 2000/01, though one large joint investment spinning company (Misr Amriya) successfully imported Greek lint, and several importers brought in Sudanese acala. Double fumigation is still required for shipments from Greece and Syria, though it appears as if Egyptian importers did not have to bear the full cost of flying MALR inspectors to the exporting country and all their local expenses.

The groundwork laid by the five APRP benchmarks paid off in 1999/00 and 2000/01, though it is critical to recognize that economic necessity (short cotton crops) was probably a more important factor in facilitating lint imports. The increasing ease of importing short- and

medium-staple lint made introduction of *hirsutum* cultivation in Egypt appear unnecessary. Some analysts argue that Egypt should not be allocating scarce irrigation water to growing inferior *hirsutum* cotton, when it can grow fine *barbadense*, particularly when the EU (especially Greece) and the U.S. are willing to subsidize their domestic cotton producers and upland cotton exports. Furthermore, low prices for Syrian and Sudanese lint lead thoughtful analysts to conclude that *hirsutum* cultivation in Egypt is a non-starter as long as world upland prices are so low. Finally, the Cotton Research Institute has never supported *hirsutum* cultivation in Egypt. Ostensibly, the CRI is afraid of varietal mixing. When assured that no one is talking about *hirsutum* cultivation in the (old) Nile valley, CRI resistance softens a bit, though the chief breeders have no interest in breeding or adapting inferior upland varieties to Egyptian growing conditions, which are ideal for *barbadense*. Their strategy appears to be one of producing high-quality fine cotton as if lint quality alone has some absolute or intrinsic value. Economic considerations, as in rigorous cost-benefit analysis, do not appear to guide such thinking. The fact that most non-Egyptian analysts see the world market niche and potential for *barbadense* as being quite narrow does not seem to influence the thinking of many CRI and MALR officials in Egypt.⁶

5.5 Privatization of Public Ginning and Textile Companies

Privatization of two public ginning companies was well underway by the time the APRP technical assistance teams arrived, although there was one ginning privatization benchmark in Tranche I. At least one public ginning company was privatized before 30 June 1997, so the benchmark was accomplished and MPE action exceeded expectations. Following the fall 1996 privatization of Arab Ginning Company and the spring privatization of Nile Ginning Company—both through stock market flotations—progress in privatizing ginning companies stalled. Despite going diligently through the valuation, preparation and advertising processes, the MPE was unable to privatize any of the three other public ginning companies. High valuations, driven by high land values, made privatization a costly proposition. Some private cotton trading companies expressed limited interest in buying selected gins in production zones with successful export varieties, but the MPE did not endorse or encourage this approach. By 1999, the entire agribusiness privatization program had slowed to a crawl. Public rice milling companies could only be privatized by offering them to employees as ESAs.

Progress in the privatization of textile companies is somewhat more positive, though also disappointing, particularly since 1999. 1996/97 and 1997/98 witnessed successful privatizations, through stock market flotations, of three public textile companies: Unirab, Alexandria Spinning and Weaving and KABO. In 1998/99, one liquidation and two leases were completed. One of the lessees is reportedly struggling, while the other appears to be doing well. In 2001, three management contracts were terminated with foreign textile consulting and management companies.

It is important to note that during APRP private investments were made in open-end spinning units, as well as one ring spinning operation specializing in producing high-count yarn. Another ring spinning start-up is supposed to come on stream in late 2002. These niche spinning investments are partially a response to economic opportunities created with the gradual

⁶ CRI officials acknowledge that medium staple varieties would be more suitable for most yarn spun in Egypt. There appears to be some (though probably limited) interest in developing a new medium staple for the Egyptian spinning industry to replace *ashmouni*, which was phased out during the early 1980s.

liberalization of the cotton/textile subsector, but also as much clever pursuing of niche market segments (open-end spinning of low counts; high-end ring spinning of fine counts) not well served by the public sector spinning companies.

5.6 General Lessons of Cotton Policy Reform in Egypt

As noted earlier, it is often very difficult to reach a consensus on a subsector strategy, given divergent interests. Cotton producers obviously want the highest possible prices for their seed cotton. Since domestic seed cotton prices and lint export prices are linked, exporters are opposed to excessively high seed cotton prices which undermine their profitability and export competitiveness. Domestic spinners, who rely most heavily on Egyptian lint, also oppose high domestic price levels. Purchases of cotton lint represent about 60% of their variable costs, so cotton (input) prices do make a difference. Domestic seed cotton buyers are less concerned about the level of cotton prices,⁷ as they focus on the spread between seed and lint cotton prices. While private exporters are willing to price Egyptian lint varieties aggressively to expand exports, domestic spinners want to be assured of domestic supplies, priced at low enough levels to enable them to be competitive in yarn export markets. As financial problems in the cotton subsector become exacerbated, as they have in 2001/02, the tendency is for individual stakeholder groups to dig in their heels, become more defensive, blame other subsector participants or the GOE for their problems, and generally be less open to compromise. This is unfortunate, because it is high time for a comprehensive and defensible cotton/textile subsector strategy that can guide future allocation of limited GOE resources, decisions about privatization methods and pace, and priorities for further reform.

One useful lesson from APRP's cotton policy reform work was that it may be necessary to pursue more than one tactic to achieve an objective. APRP designed benchmarks to facilitate lint imports as well as to promote *hirsutum* production. Both benchmarks were intended to increase the supply of cheaper, shorter-staple lint to financially strapped spinning companies in Egypt (mainly public companies). This strategy recognized that Egyptian spinners produce mainly low- and medium-counts of yarn, largely for domestic consumption. As discussed in section 5.4, the tactical approach of simplifying lint imports ultimately succeeded, while the approach of promoting *hirsutum* production failed. As long as the underlying strategic objective was achieved, the fact that one approach worked (while one did not) was good enough.

In some cases, a policy benchmark was either not fully accomplished during a particular tranche, or it was drafted but not approved for inclusion in the annual Memorandum of Understanding between the GOE and USAID/Egypt. This did not always mean, however, that the policy issue was dead or that there was no chance of getting policy changed later in the APRP program. What the RDI Unit sometimes did was to reformulate the benchmark and submit it for later approval.⁸ Alternatively, a draft benchmark was dropped from a tranche, but RDI shifted to

⁷ Domestic cotton prices may affect the volume of seed cotton that small- and medium- scale traders are able to buy if they wait a long time for payment by larger trading companies. Smaller traders' working capital is likely to be limited, so higher prices will limit that quantities they can buy if finance is constrained.

⁸ During tranches 1-3, cotton policy benchmarks were developed under the broad policy reform category of prices, markets and trade. Following USAID protests about proposing more cotton benchmarks under that category in tranches 4 and 5, the RDI Unit proposed cotton benchmarks under different guise (usually avoiding mention of cotton in the benchmark title) in the policy reform category of agricultural support services and institutions.

complementary implementation activities for a tranche. Implementation work with advocacy organizations, such as ALCOTEXA, or with key GOE agencies allowed RDI to build consensus behind the scenes quietly or to provide information and analysis to potential policy champions, typically technocrats in a GOE agency, that could be used later in support of a particular policy reform. Sometimes, simply getting an issue on the policy reform agenda can be an important achievement, even if it is initially rejected by an official or agency. While the time may not be ripe to push a particular reform, raising the issue initially and providing sound analysis to potential champions of the reform can lay the groundwork for a formal policy benchmark and its eventual accomplishment.

6. PROGRESS IN COTTON SUBSECTOR LIBERALIZATION DURING APRP

This chapter will outline accomplishments during the APRP era, offer some observations on attribution to APRP, and discuss threats and barriers to continued liberalization beyond APRP.

6.1 Progress in Liberalization

The biggest achievement of cotton policy reform in Egypt has been strengthening of the private sector in the seed cotton trade, ginning industry, lint export business, and spinning industry. Since 1994/95, private sector market shares have expanded significantly, with the exception of the trade in seed cotton, as shown in Table 6-1. By 2000/01, the private sector share had attained 36-51% in four key cotton industries, representing impressive progress. The exit of the private sector from the seed cotton market in 1996/97 led to a slow but steady re-entry of private traders from 1997/98 on. The private sector share of seed cotton marketing was actually highest in 1995/96, when it was 52.8%. The changes between 2000/01 and 2001/02, which is nearing completion, are that private sector shares dropped slightly for the seed cotton trade (to 31.3%) and ginning (33.7%), while expanding for lint export (64% of export commitments as of late July 2002) and probably for yarn output (though no figures are available).

Table 6-1: Changes in Private Sector Market Shares of Output/Trade in Selected Industries of the Cotton Subsector, 1994/95 to 2000/01

(in %)

Industry	1994/95	1996/97	1998/99	2000/01
Seed cotton trade	30.8	0.1	19.6	36.2
Ginning	23.4	24.0	39.6	41.6
Lint export	4.3	8.8	27.3	51.4
Yarn output	14.3	24.9	35.9	40.1

Sources: Holtzman et al., 2002. *MVE Monitoring Report No. 4*, Krenz et al., 2001. *MVE Impact Assessment Report No. 17*.

Notes: 1) 1994/95 is chosen as the base year, as it was the first year of cotton market liberalization.
2) Shares for the seed cotton trade represent deliveries to the gins. Note that this is an under-estimate of the share of seed cotton bought from farmers (so-called first purchases).
3) The ginning share for 1994/95 represents lint cotton output of (public) gins leased by private companies. There was no private ownership of gins until 1996/97.
4) The private sector share of lint exports for 1994/95 is not available; the share is for 1995/96.
5) Yarn output includes production of 100% cotton yarn (the vast majority) as well as cotton/synthetic blended yarn, the most common of which is cotton/polyester. Note that yarn output is for GOE fiscal years (July to June) rather than cotton market years (September to August).

It is important to note that increases in the private share of lint exports and yarn output have come, in part, at the expense of a declining public sector. Public cotton trading companies' export commitments, as of late July 2002, were as low (in absolute terms) as they had been since the very poor export marketing year of 1995/96, when only 18,800 mt of ELS lint were shipped. The main reason for the poor export performance of the public trading companies in 2001/02 was aggressive pricing of lint exports by private exporters, where discounts below ALCOTEXA

minimum export prices ranging from 5¢ to 20¢ were offered. Unable to offer discounts of this magnitude to foreign buyers, public trading companies had received commitments of only 37,571 mt of a total of 102,961 mt as of late July. At the same time, unsold stocks of lint have piled up.

The major increase in the private sector share of yarn output is due in part to an impressive increase in estimated private sector production, from 25,212 mt in 1992/93 to 91,914 mt in 2000/01. Over that same period, public spinning company output fell from 266,946 mt to 114,079 mt, a 57% drop. This led total yarn output to drop 29% from 324,369 mt in 1992/93 to 229,101 mt in 2000/01. Therefore, higher private spinner production over a much lower denominator made the expansion in private sector market share especially strong.

6.2 What Can Be Attributed to APRP?

Clearly, not all of the expansion in private sector market shares can be attributed to APRP. APCP got cotton policy reform underway, and the private sector participated in seed cotton buying, ginning, and lint export for two full marketing seasons before APRP began. Positive changes in the macroeconomic environment in Egypt also reinforced cotton market liberalization. These changes, reinforced by a World Bank SAL in the early 1990s included fiscal stringency and better balancing of the GOE budget, exchange rate adjustment, freeing up of administered prices in many parts of the economy, phasing out of some subsidies in agriculture and elsewhere, and an initial commitment to a privatization program. Reported GDP growth rates of 4-6% during much of the 1990s in Egypt strengthened the overall economic and investment climate, though growth rates in sectors such as construction, certain industries (like cement), tourism, and certain service industries outpaced growth in the agriculture sector or agribusiness system.

Despite these broader trends and factors contributing to economic growth, APRP did continue to provide momentum to agricultural sector policy reform efforts initiated under APCP but strengthened by a larger and more focused technical assistance team.⁹ Between APRP and CSPP, there were at least five full-time equivalent analysts working on cotton issues, as well as numerous short-term consultants and key research managers, who provided intellectual guidance and support to this work. APRP tenacity in supporting cotton market liberalization have contributed, over a six-year period, to broader private sector participation and greater private sector shares. Benchmarks and implementation activities designed to eliminate marketing rules and pricing practices that discriminated versus the private sector did eventually have a positive impact, although progress was not always linear or as rapid as hoped. High-quality, well-delivered, incisive and convincing economic analysis influenced stakeholders, although not all of them were willing to accept initially the logical policy conclusions and recommendations that came out of this analysis.

Although APRP contributed to agribusiness system privatization at the margin, its role and significance in the GOE's privatization program, supported by several USAID-funded projects, was limited. Privatizations early during APRP, such as the sales to private investors of a majority of shares of the two ginning companies, Arab and Nile Ginning, and of three textile

⁹ The technical assistance was more focused on agriculture and particularly on the downstream agribusiness system than APCP. APCP concentrated more on production agriculture. A large part of the APCP technical assistance effort was directed to strengthening PBDAC, a lending institution.

companies, KABO, Alexandria Spinning and Weaving, and Unirab, cannot really be attributed to APRP. It can be argued, however, that specific benchmarks and hence cash transfers tied to achieving APRP privatization benchmarks provided the GOE with an incentive to meet the targets. Nevertheless, the background preparation, valuation and advertising for bids took place either before APRP's technical assistance teams arrived or shortly thereafter. APRP was tangentially involved in the ESA privatizations of public rice milling companies that were completed largely in 1998/99, though more heavily involved in providing post-privatization support to the ESA rice milling firms. APRP work on developing improved leasing and management guidelines were useful to MPE/PEO, although the two largest leases of spinning mills to private entrepreneurs, DIP-Egypt (of ESCO) and Menia al Kamh (of Sharkeya Spinning and Weaving) were negotiated before these guidelines were finalized, approved by the PEO and widely disseminated.

Outside of the scope of APRP, devaluations of the Egyptian pound against the U.S. dollar in August 2000 and December 2001, well into APRP, also had positive effects.¹⁰ ALCOTEXA lowered its opening (of the marketing season) minimum export prices, quoted in cents per lb., between 2000/01 and 2001/02 by 6% for Giza 70, 11% for Giza 86, and 13% for Giza 89. Export revenues, once converted from dollars to Egyptian pounds at the official exchange rate, were higher in LE terms in 2001/02 than in 2000/01 for Giza 70, as the devaluation was about 8%. When converting at the higher informal market exchange rate adjustment of LE 4.8=\$1 or higher, LE returns from exporting Gizas 86 and 89 were also higher in 2001/02 than in 2000/01 in LE terms.¹¹

The devaluations also provided some support to the ailing Egyptian spinning industry. Not only did cotton yarn exports expand in 2000 relative to 1999, but some spinners reported that yarn imports from competing producers (India, Pakistan) declined because these imports were more costly in LE terms after the devaluations. Evidently, some private sector Egyptian weavers, knitters, and RMG manufacturers found domestic yarn spun, mainly spun from long-staple Egyptian lint, more attractive relative to imported yarn spun from shorter-staple lint. The extent to which this translated into a significant decline in the overall volume of yarn imports is unknown.

The fact that the Egyptian pound was pegged to the dollar for a period of over eight years¹² ended up earlier penalizing Egyptian exports. As the real value of the pound fell over this period, while the exchange rate was virtually fixed to an increasingly strong dollar, Egyptian exports became less competitive in world markets. Following the Asian financial crisis of 1997, the yarn and other textile exports of many Asian countries became cheaper in dollar (and other forex) terms.

¹⁰ It is important to note that the USAID-funded DEPRA (Development Policy Reform Assistance) project strongly advocated exchange rate adjustment. APRP policy advisors also called for allowing the Egyptian pound to float or for devaluation, though not quite as vocally and without the same access to the Ministry of Economy and the Ministry of Foreign Trade.

¹¹ The fact that most private exporters deeply discounted lint export prices in 2001/02 undermines the validity of this argument somewhat. The disparity between the official exchange rate after mid-December 2001 and the parallel rate, reportedly as high as \$1 = LE5.1-5.2 at times in 2002, offered an opportunity for a windfall gain, but exporters' discounted export prices deeply offset this advantage to a large extent.

¹² The exchange rate to the dollar was LE 3.222 in May 1991. In November 1994, it reached LE 3.394 = \$1, after which it stayed within the narrow range of LE 3.388 and LE 3.341, reached in January 2000.

This hurt Egyptian exports in a number of high-income country markets in Asia (particularly Japan) and in Europe. Egyptian yarn exports dropped from 68,110 mt in 1997 to 49,905 mt in 1998 and 35,736 mt in 1999, largely due to the devaluation-driven competitiveness of Asian yarn exports. In the final analysis, it is important to remember that the overvaluation of the Egyptian pound hurt the competitiveness of many Egyptian agricultural and agribusiness exports, including cotton lint, yarn, fabric, knits and RMGs.

Another donor program contributing resources, including technical assistance, to the cotton subsector has been the Cotton Sector Promotion Program (CSPP). To the extent that there have been any gains in cotton productivity since the mid-1990s, the CSPP can take a good part of the credit for them. CSPP has worked closely with MALR to improve farmers' production practices through use of delinted cotton seed, IPM and more appropriate, better-targeted use of pesticides on cotton, and better extension messages and supervision regarding cotton agronomy. APRP did little or no work on cotton production practices, though it did analyze recent trends in yields by variety (see Ariza et al., 2000) and provide annual input into the cotton variety map from 1998 on.

An indirect, though still important, benefit of APRP's heavy emphasis on the cotton subsector was the fact that cotton did not drop out of the summer crop mix in Delta governorates where rice is grown. Paddy area, by 1999 and 2000, exceeded by a wide margin the combined cotton and maize area in the six major Delta governorates where rice is grown plus Fayoum.¹³ APRP persistence in working on cotton eventually paid off. Cotton area returned to more normal levels in 2001 and 2002 (over 700,000 feddans nation-wide in both years), relative to rice area.

6.3 Threats to Liberalization of the Cotton Subsector

During the past two marketing seasons, the Cotton Marketing Supervisory Committee has allocated the PBDAC rings with little input from the private sector. Only two private sector representatives, not chosen by the private sector, sit on the inner committee which makes the important decisions about who gets which PBDAC rings and the how the annual Optional Marketing System decree, issued in August and signed by four Ministers, gets implemented. In effect, the Supervisory Committee sets the rules of the marketing system. Through 1999/2000, the Cotton and International Trade Holding Committee, in consultation with the Domestic Cotton Traders' Committee, allocated PBDAC rings.

As of 2000/01, the Cotton Trader Committee's input was no longer sought. The Supervisory Committee took a number of decisions that antagonized the private cotton trade. First, it gave private traders only four days, over a weekend, to apply for PBDAC rings and deposit LE 5,000 per ring. Private traders protested this, arguing that the time for applying was too short and that LE 5,000 per ring was too high a sum, which tied up traders' funds and gave PBDAC an interest-free loan for months. Furthermore, public trading, ginning and spinning companies were not required to pay any deposits. Third, the Supervisory Committee told larger trading companies that they could buy from cooperatives, but that any quantity purchased from coops and delivered

¹³ Paddy area in the seven major rice-producing governorates covered 1,476,985 feddans in 1999, 23% more area than the combined area of cotton (545,089 feddans) and maize (654,450 feddans). In 2000, the margin was even greater, 62%, as paddy area of 1,517,573 feddans exceeded cotton (386,090 feddans) plus maize (548,645 feddans) area. In that summer cropping season, paddy area was nearly quadruple cotton area in the seven major rice-producing governorates.

to the gins would count against their “quota,” the quantity estimated based on the number of PBDAC rings they were allocated. Fourth, private traders’ reported that the Supervisory Committee threatened to instruct CATGO not to grade any seed cotton delivered to the gins that had first not been graded at a PBDAC ring (and hence bought through the PBDAC ring system). This rankled a number of large traders, who got around this restriction by pre-financing smaller buyers who had PBDAC rings, who in effect were commission agents who supplied them (i.e., the large traders) with seed cotton.

The series of arbitrary decisions and actions undertaken by the Supervisory Committee in August-September 2000 unleashed a vehement wave of protests from private traders, who sent faxes to Ministers, published letters in newspapers, and complained bitterly to PBDAC and the Supervisory Committee. This strong and vocal advocacy effort led Ministers Wally and Ghaly to publish an announcement in all the major newspapers in late September 2000 that stated that the cotton marketing system was open and free to all buyers. This announcement implied that it was acceptable for private traders to buy outside the PBDAC ring system and that CATGO would grade seed cotton at the ring. This announcement undercut the power of the Supervisory Committee and was a victory for the private trade and their advocacy efforts. It was also a sign that there would be more transparency in implementation of cotton marketing decrees. The outcome was that private sector deliveries to the gins equaled 36.2% of the seed cotton crop, nearly as high as the 36.7% of 1999/00.

The private sector share might have been larger had the Horticultural Services Unit, formerly run by the Chairman of PBDAC and the Supervisory Committee, been granted little or no market share in 2000/01. HSU’s market share was in fact a whopping 26% of the seed cotton crop, up from nothing in 1999/00. This share was entirely administratively allocated by the Supervisory Committee on the grounds that HSU was the appropriate agency to manage the purchasing of seed cotton used to produce certified seed (used in the following year’s planting). The fact that HSU bought nearly one million seed kentars of cotton in order to acquire sufficient seed for the following crop was clearly an abuse of the Supervisory Committee’s license to implement the optional marketing system decree, as well as an exaggerated quantity well beyond what was actually needed. HSU took title to the cotton lint coming out of the gins, which it sold at a premium in 2000/01 to cotton exporters, mainly public trading companies. Note that HSU was allocated a disproportionately large share of the Giza 70 crop, allegedly because Giza 70 was the export variety in highest demand. This fact did not go unnoticed by the private trade, which complained bitterly of parochialism and favoritism towards this quasi-governmental organization, HSU. In 2001/02, HSU again collected nearly one million seed kentars, representing a lower percentage (18.2%) of a larger seed cotton crop than in 2000/01, but still unjustifiably large. Technically qualified observers state that only a fraction of this quantity, probably no more than 20%, is adequate for obtaining sufficient certified seed.

Another potential threat to cotton market liberalization is the ALCOTEXA practice of setting minimum export prices. In 2001/02, this system clearly discriminated against public sector trading companies, as they had to play by the rules, offering lint for export at prices no lower than the minimum export prices, while private exporters were able to sell their lint at highly discounted prices. The predictable result was that the private sector share of exports was nearly two-thirds, well above any earlier year. While strong private sector performance is laudable, using the minimum export price system, which public trading companies must abide by, to take public traders out of the market is a clever though anti-competitive measure. The obvious policy recommendation is to do away with minimum export prices, though public traders, HC officials,

and other GOE representatives argue that such a system is required to monitor effectively and audit the public companies. Unfortunately, this is a case of accounting and auditing run amok, and evidence of how distorted incentives are in public companies and holding companies. These entities focus entirely on costs and building in elaborate checks and balances; the whole public enterprise system is built on mistrust. The emphasis is on capturing market share at whatever cost and whatever the profitability, rather than on earning profits.

Most of the greater private export market share in 2001/02 has gone to two leading firms, whose combined share is 42.5%. There is a danger that cotton lint trading, both the domestic trade and lint export, will become more concentrated over time, despite the fact that 2001/02 witnessed a record number of exporters (n=17). The leading firm is vertically integrated into ginning, cotton trading, and spinning (through a partner firm). The number two firm has a special arrangement with a public ginning company and is establishing a high-count spinning factory. Other larger private exporters have contemplated investments in gins. Increasing concentration and vertical integration are inevitable in a subsector where inter-annual supply variability and government-induced policy uncertainty increase the risks of doing business. Some observers point out that a \$200 million/year business, which is the value of lint exports from Egypt, is probably not a large enough market to attract high levels of participation. Broader private sector participation is more suitable for the seed cotton trade, where collectors in rural areas can assemble from a large number of dispersed growers. The export trade will likely become more concentrated over time, as smaller and weaker competitors drop out of the business. The long-run viability of public cotton trading companies is also questionable without preferential access to public bank loans, downsizing of their labor force, and reduction of debt.

A last recurrent cotton marketing system problem which threatens its viability is large carryover stocks. After the carryover was reduced from 4.2 mlk at the beginning of 1998/99 to about 1.0 mlk at the start of 2001/02 (in increments of about 1.0 mlk per year), it has increased again during 2001/02. Figures through 11 August 2002 were: stocks of 2.46 mlk, with export commitments at that time of 2.11 mlk and domestic utilization of 2.77 mlk. Stocks were highest for Giza 86 at 927,000 lk and Giza 89 at 658,000 lk; together they accounted for 64.6% of total stocks.

The carryover issue is an important one, because someone or some agency must bear storage and finance costs. As of 1 September, the public cotton trading companies no longer own the cotton lint; it belongs to the GOE. Such a system, which provides incentives for public trading companies to buy as much seed cotton as possible, whether or not they can move the resulting lint into domestic and foreign markets, is flawed. No one takes responsibility for accumulating these massive stocks, though ultimately the GOE must pay for them. The willingness of the public sector banks to finance overbuying by public trading companies and the accumulating stocks that cannot be moved has been called increasingly into question. Financially, the marketing system may grind to an impasse in 2002/03.

Even if the banks continue to fund assembly of large volumes of seed cotton by public trading companies, the large carryover stocks going into 2002/03 are evidence of a serious misallocation of resources. The carryover problem is a result of several factors:

- Overproduction of certain varieties relative to domestic and apparent foreign demand.
- Inappropriate pricing of certain varieties, leading to slow sales in foreign markets relative to competitors, mainly pima.

- A varietal map that does not adequately reflect market realities and private sector input. LS and ELS production have been emphasized, while production of a medium-staple variety (like *ashmouni* for many years) would satisfy much of the domestic spinning industry's needs at lower cost.
- Limited domestic and foreign demand for ELS and certain types of LS.
- Egypt's continued international reputation for contaminated lint and unfair arbitration (through ALCOTEXA) that favors Egyptian exporters and discriminates against foreign buyers.

Until these issues are squarely addressed, the prospects for eliminating or greatly reducing carryover are poor. High levels of cotton stocks during a period of fiscal tightness and stringency, overall economic weakness, and mounting banking system problems underscore the need for orderly disposal and some type of resolution. The problem may get worse in 2002/03 than better, with an expected large crop (sown on some 740,000 feddans) and continued soft domestic demand for Egyptian lint, where national utilization will likely fall in the 2.7-3.0 mlk range rather than the 4.0 + mlk level of 1997/98 and earlier years.

7. RECOMMENDED POLICY REFORMS

Liberalization of cotton marketing in Egypt is clearly at an important crossroads eight years after private traders were allowed to (once again) buy seed cotton. Swift and bold decisions need to be taken to avert a financial crisis that precipitates the rapid demise of public trading and spinning companies. Business as usual will not do. The GOE, the HC and its affiliates, the private trade, and cooperatives need to reach some consensus. But can a consensus be reached in the contentious current environment surrounding the cotton subsector? This section will offer MVE's recommendations for further policy reform in specific areas that, if implemented, would help resolve the current crisis.

7.1 Lint Exports

A high priority is to do away with ALCOTEXA's minimum export prices (and grades). ALCOTEXA could consider issuing indicative prices, but not set minimum export prices that are legally binding (at least for public sector cotton trading companies). A GOE counter-argument for abandoning minimum export prices may be that the only way to monitor the public trading companies and account properly for their returns is to have minimum export prices, which serve as de facto fixed prices. Such a system, as the argument goes, leads to perfect transparency and can withstand any Central Auditing Agency audits of public company finances. While fixed prices may facilitate accounting transparency, if the current system of minimum export prices is maintained, the lint export share of public companies will continue to shrink, as private exporters are willing and able to discount prices below the supposed minimum levels. See section 7.6 below regarding why it is important to maintain the public trading companies in the short and medium term.

Through much of APRP, the playing field was tilted in favor of public sector cotton trading companies. They controlled ALCOTEXA's Management Committee, making the export rules and setting the minimum export prices. They received the largest number of PBDAC sales rings to buy seed cotton. By 2001/02, the balance of power had shifted to the private sector exporters, who controlled ALCOTEXA's Management Committee as of 1 January 2001. One area where public exporters were discriminated against during the past two marketing seasons was in converting dollars to Egyptian pounds. They had to do this conversion at the official exchange rate through the public sector banks, while private exporters could hold dollars in forex accounts at banks of their choice and convert these dollars, as needed, into pounds at the prevailing open market rate, which was significantly higher than the official rate. This flexibility in handling and converting dollars gave private exporters a competitive edge against public trading companies.

Another policy priority affecting export levels and prices is to reduce lint carryover, which will overhang the world market and depress prices for LS and ELS lint in 2002/03. Avoiding carryover requires pricing flexibility; when minimum lint export prices are set too high, relative to U.S. pima and other growths, export volume is reduced and stocks accumulate. Large carryover is also a function of declining domestic demand for and use of Egyptian lint. As more cheaper, shorter-staple foreign lint is imported, domestic utilization of Egyptian LS and ELS lint will decline. If world market demand for LS and ELS is not stimulated and expanded, the size of the Egyptian cotton crop will likely decline, unless maintained artificially high through fixed producer prices. In the final analysis, price policies at all levels of the cotton marketing system will affect output, stock, domestic use, and export levels. Carryover will not be reduced unless

domestic and international prices are allowed to vary with changes in underlying supply and demand conditions.

7.2 Seed Cotton Varietal Map

A logical conclusion of the preceding discussion is that the problem of excessive carryover stocks is tightly linked to how much of which particular cotton varieties are planted in a given year, and the price levels established for each variety. The cotton varietal committee remains a MALR-dominated group of breeders, agronomists, plant pathologists and extension managers. While these agricultural specialists need to provide technical input into discussions about varietal mapping and they may continue to take the lead, it is definitely not the case that they can or should represent traders, ginners, spinners and other industry participants or substitute for industry input. The committee claims that it actively solicits public and private industry input. While it contacts the heads of the HC-SWRMC and ALCOTEXA for their opinions, this does not necessarily represent a broad range of industry opinion.

MVE recommends that the varietal committee change from a semi-formal, entirely MALR and ARC decision-making body to a larger, more formal committee with broader representation, including both public and private traders, ginners and spinners. Industry participants need to be formally represented on the varietal committee in sufficient numbers to exercise clout. A “management committee” of a more limited number of members could prepare and present an annual plan to the broader committee (and other interested, though perhaps non-voting, participants who are not part of the committee) for discussion and review. This interaction would be a better way to arrive at a consensus than canvassing the opinions of individual industry representatives. It could also be constructive for industry players to understand the technical factors that go into varietal zoning, such as seed quality and availability, soils, and temperature and humidity levels in different districts. Any formal presentation of a plan should come early enough so there is time to modify the plan and present it again. Eventually, it would be highly desirable for the committee to develop a multi-year plan, rather than more ad hoc year-to-year plans.

7.3 Seed Multiplication and Buying

The fact that one public organization bought 26% of the total seed cotton crop in Egypt in 2000/01 and 18% in 2001/02 in order to procure seed for the following year’s sowing is evidence of policy failure. Entire districts are allocated to seed production on the grounds that isolation is required to ensure varietal purity and quality seed. This is exaggerated and unnecessary. Knowledgeable observers report that probably 3-4 times as much cotton area is allocated to seed multiplication as is really required. Public and private cotton industry representatives complain that allocating so large a proportion of the cotton area to one organization is an abuse by the Supervisory Committee of its authority, enabling HSU to capture windfall, unearned profits.

Many cotton experts call for a return to the old system, where less cotton area was allocated for seed production. Cotton experts now note that as delinted seed is sown on a wider area in Egypt that required seed volume for planting has decreased. Under the pre-HSU system, cotton for seed was selected in the field, it was bought by multiple parties who delivered it to the gins, and multiple traders took title to the seed cotton. There is no reason why such a system could not be re-implemented in Egypt.

7.4 Strengthen the Domestic Cotton Traders' Committee

This committee was created to register domestic cotton traders in 1994. It still plays that role, receiving LE 3,000 per firm as a (refundable) deposit to join and LE 500 per year in dues. This committee has registered 240 entities since 1994, including the following:

- public trading, ginning, and spinning companies
- private exporters (ALCOTEXA members)
- smaller domestic private traders
- field crop marketing cooperatives
- other cooperatives
- miscellaneous public entities, such as HSU and the holding company

Quite a few of these members (n=101) had dropped out of the seed cotton trading business by early 2002, revoking their registration, and receiving a refund on their deposit; hence, 139 members were still registered as of early 2002. Note that 15 new companies had registered by the beginning of the 2001/02 marketing season.

Prior to 2000/01, this committee participated with the Cotton and International Trade Holding Company in allocating PBDAC sales rings to public and private buyers. For several years in the late 1990s, the committee played an important advocacy role. Public trading companies claimed that the private sector was able to get first pick of the rings (varieties and locations) that it wanted before the rest of the rings were allocated to public companies. By 2000/01, with a new PBDAC Chairman, who also headed the Cotton Supervisory Committee, the Domestic Cotton Traders' Committee was marginalized from the decision-making and ring allocation process. Private sector protests of arbitrary Supervisory Committee decisions at the beginning of 2000/01 were not orchestrated by the Domestic Cotton Traders' Committee; rather, they were individual protests.

MVE advocates that USAID or CSPP undertake an organizational assessment of the capabilities, strengths and weaknesses of the Domestic Cotton Traders' Committee. If this committee is deemed worth supporting, an in-depth needs assessment should also be conducted. A donor could fund technical assistance to the Domestic Cotton Traders' Committee, strengthening its capability to advocate policy reform and influence the policy agenda. The objective of this exercise would be to strengthen domestic traders, particularly private traders and cooperatives with no other means of voicing their concerns, as important stakeholders in the policy reform and market liberalization process. MVE recommends that this committee, rather than the GOE, choose private sector representatives to the Supervisory Committee, the varietal mapping committee, the High Cotton Council, and any other committee providing input to senior policy makers or making key implementation decisions that affect the seed cotton trade. Such an organization could also double as an ACC cotton trade subcommittee, where cotton is notable by its absence.¹⁴

7.5 Cotton Pricing Recommendations

¹⁴ Probably the main reason why there is no cotton subcommittee within ACC is that ALCOTEXA is already a powerful advocacy organization for the private and public cotton export trade. Private sector ALCOTEXA members represent only a subset of the domestic cotton seed traders, however.

In addition to removing minimum lint export prices, discussed in section 7.1, MVE recommends setting producer floor prices (or guaranteed producer prices) at levels lower than during some past seasons, when trading margins were squeezed or negative. In this way the GOE should work towards true floor prices. When set at moderate to high levels, producer prices tend to become fixed prices around which there is little variance, even if private traders are theoretically allowed to pay whatever price they want to farmers outside PBDAC sales rings. In actual practice, prices paid by private traders outside rings follow official prices paid at PBDAC rings very closely. In the case of a few sought-after export varieties, such as Gizas 70 or 86, in a few years, private traders have paid premium prices outside PBDAC rings. This is more the exception than the rule, however. Typically, private traders have to offer somewhat less than buyers at PBDAC rings in order to earn their marketing margin on sales, generally of seed cotton (and not lint), to larger trading companies.

Into-mill lint prices paid by domestic spinners are tied administratively to ALCOTEXA's export prices and official seed cotton prices paid at PBDAC sales rings. To the extent that ALCOTEXA's minimum export prices are based on world prices of competing growths, lint prices paid by domestic spinners reflect the international opportunity cost of Egyptian lint. These spinners complain about how expensive Egyptian lint is. These complaints are true, because Egyptian lint is high-quality, fine LS and ELS, used outside Egypt to produce high-value yarn, fabric, knits, and RMGs. In many spinning companies, fine Egyptian cotton gets underspun into low- and medium-count yarn, representing a misuse of expensive raw material. It is also important to note that in years during which ALCOTEXA export prices are set too high, domestic spinners are also penalized in having to pay high lint prices based on the too high export prices.

In recognition of the high cost and value of Egyptian lint, and attempting to subsidize the poorly performing domestic spinning companies, the HC-SWRMC proposed a two-tier lint pricing system to domestic spinners in 2000/01. Under this system, private sector and joint investment spinning companies would pay higher prices for Egyptian lint than public companies. It is not clear to what extent this scheme was actually implemented. Nevertheless, it set a bad precedent, suggesting that the GOE was willing to subsidize the operations of public spinners while letting private and joint investment spinners face the competitive forces of international competition.

In the future, prices paid for Egyptian lint by spinners should not be fixed, although they will be based indirectly on export prices. Prices for different lint varieties should be based on both domestic and international supply and demand conditions. Prices for imported lint, generally shorter staple, will also affect Egyptian lint prices in the domestic market. The practice of price discrimination by market segment, favored by the HC-SWRMC in 2000/01, should be discouraged. A free and open domestic lint market, where Egyptian lint competes with imported lint, will provide domestic spinners with the widest quality and price range possible to meet their spinning requirements for both the domestic and international yarn markets.

7.6 Revisit Privatization

Privatization of ginning and spinning companies stalled in the late 1990s. There have been no successful, completed privatizations since 1999, when leases were signed with private textile producers for use of spinning units of the Minya El Qamh and Cairo Dyeing and Finishing companies. Attempts to privatize two of the remaining three public ginning companies in 1998/99 failed; valuations were high and companies were offered in their entirety as package deals. MVE has previously recommended (see Krenz and Mostafa, 2000 and Krenz et al., 2001) that the public ginning companies sell off individual gins on a piecemeal basis. Egyptian cotton exporters, the most likely candidates to purchase gins, may be interested in buying individual gins in production zones where the most popular export varieties are grown. The MPE and the HC-SWRMC do not appear to have been particularly receptive to this approach, probably because the ginning companies opposed selling off of their best assets. Discussion of merging the three public ginners into one company in the spring of 2001 also seemed to go against MVE's recommendation. Since this merger never took place, MVE recommends offering individual gins for sale to interested cotton traders and other prospective investors.

The steady decline in the yarn output, capacity utilization, and exports of the public sector spinning companies are evidence of failure to adapt to changing domestic and world market circumstances. Despite the best efforts of the PEO, APRP, and two USAID-funded privatization projects, privatization of spinning companies in Egypt has a limited track record. The reasons for failure are well-known and have been discussed in depth elsewhere (see Holtzman, 2000). Nevertheless, privatization needs to be revisited by the GOE, particularly the MPE and the HC-SWRMC. Political will to address difficult and intractable problems head-on is required. Perhaps triage of public spinning units is needed to get privatization back on track, where privatization efforts are focused on the best performing public spinners in the short to medium term and a few of the struggling spinners, deemed revivable, are provided with technical and financial assistance for restructuring.

Privatization of public sector cotton trading companies, perhaps one per year over the next several years, could also help to complete liberalization of the cotton trade. Private sector trading companies are probably not yet prepared or financially strong enough to buy the entire seed cotton crop.¹⁵ But they are capable of buying a large proportion of the seed crop if the HSU share were radically shaved or eliminated, if the Domestic Cotton Traders' Committee were able to influence the allocation of PBDAC sales rings, and if the Cotton Supervisory Committee had greater private sector representation. It is argued that public trading companies are required to buy up that part of the seed cotton crop that domestic traders are unwilling to buy, particularly the so-called non-exportable varieties.¹⁶ In the short run, this is probably true. Hence, there is a logic to retaining perhaps a couple of the cotton trading companies over the medium to long term as buyers of last resort, while selling off the rest in the short to medium run. Cotton trading companies could be offered to their employees as ESA companies, as private exporters or

¹⁵ Financing of the seed cotton crop is an issue that has received little attention under APRP and is probably worthy of more intensive scrutiny. It is likely that limited access to bank credit constrains the quantities of seed cotton that private firms, particularly smaller traders, can buy.

¹⁶ Dahmouh and Ariza (2002) argue that all Egyptian cotton varieties are exportable if properly priced. The reason for the build-up of carryover of some varieties is that they are priced too high, relative to competing growths, to move in export markets.

potential private exporters have no interest in acquiring large trading companies with limited assets, too many employees, and debts.

7.7 Look for Ways to Improve Cotton Productivity

Several analysts have called attention to the fact that cotton yields have not improved much since the 1980s in Egypt. Empirically, the actual growth rates, positive for some periods, depend very much on the base year selected and the length of the period of analysis. Under the best case scenarios, however, yields have been relatively flat and cotton breeding research in Egypt has been characterized as, at best, “maintenance research.”

Since big yield breakthroughs are unlikely to come out of the current Cotton Research Institute’s breeding program, some analysts have suggested a thorough review of Egypt’s cotton breeding program by world-class cotton scientists, assuming one could interest them to undertake such a review or that the CRI would subject itself to scrutiny. Alternatively, Egyptian scientists could take a series of study trips to visit cotton breeders and their programs in different parts of the world, such as the U.S. Hopefully, Egyptian scientists could learn from these programs and improve yields in Egypt.

Beyond the breeding program, there are a series of agronomic factors that limit cotton yields. These have been well-articulated in a recent CSPP report by Hannover (2002) on cotton agronomy. These include land preparation practices, planting dates, seeding rates, plant density and spacing (and thinning out practices), weeding practices, weak extension programs and agents, and other factors. The economic issues related to the widespread farmer application of non-optimal cotton growing practices are complex and beyond the scope of this paper, but suffice it to say that more applied research is required and efforts to resolve constraints implemented. CSPP is working closely with different technical departments of the MALR to address key constraints. A fundamental problem, related to late planting of seed cotton, is the farmer selection of wheat and long berseem as winter crops, which lead to April-May harvesting and late cotton planting, which lowers cotton yields. When thinking about crop rotations, crop mix decisions shift from comparing single crops within the same season to analysis of returns to competing rotations. Both CSPP (1998, 2002) and APRP (see Morsy et al., 2002) have done good recent work on this, though more work needs to be done, particularly sensitivity analysis of how returns to different rotations vary depending on input and output prices, planting dates, yield levels, and hired labor utilization and wage rates.

7.8 Alternative Visions of the Future

APRP accomplished a number of important things in the cotton/textile subsector during its six years and five tranches of operation. It:

- Improved economic analysis and policy dialogue
- Increased transparency in GOE decision-making
- Promoted greater market liberalization
- Expanded private sector market shares in trading, ginning, exporting and spinning
- Facilitated (and increased) lint imports

- Helped promote lint exports
- Helped improve market information

Much remains to be done, and strategic USAID, CSPP and other donor interventions can help move liberalization along further with less resources (and policy-conditioned tranche funds) than in the past. Important decisions, as outlined in this chapter, need to be taken, however, and taken quickly to avert financial crisis and continued deterioration of parts of the subsector. If political inertia, back-sliding on certain reforms, a management culture of finger-pointing and blaming others, and immobilizing inaction persist, however, problems could be exacerbated and the overall cotton economy of Egypt could worsen, with the following features:

- Carryover remains high, perhaps gets larger, and leads to marketing problems (overhangs world markets and depresses prices, or gets dumped inappropriately).
- Larger crops (of 700,000 feddans or more per growing season) lead to large shares and big financial losses for public cotton trading companies. Public ginning shares expand somewhat, but with marginal financial benefit.
- Public trading company export shares remain low and perhaps decline.
- Public spinners use less Egyptian lint, use modest quantities of imported lint, and continue to lose market share to private (and joint investment) spinners.
- Public sector banks balk at continuing to provide finance to public trading companies, which could reduce their scope of operations, and to public spinners, which leads them to operate at even lower levels of capacity utilization.

The reason for mentioning these possible negative consequences of GOE inaction, indecisiveness and any back-sliding is not to insist that a pessimistic vision is more likely to emerge than a positive one. Rather, it is intended to highlight the urgency for future reforms and bold action to break policy and implementation logjams, particularly as they affect public sector cotton trading and spinning companies.

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